Lachmann’s Kaleidoscopic Market

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A comprehensive paradigm, unquestioningly accepted by a majority of economic thinkers (and, following them at due distance, by the rest of the profession) in all five continents is not a ‘natural,’ and perhaps not even a very healthy state of affairs.

— Ludwig M. Lachmann

Within Austrian circles, Ludwig Lachmann is a controversial figure. Exposed to Carl Menger and Ludwig von Mises during his collegiate years, Lachmann surfaced during the 1930s as a leading scholar of the Austrian School. It was around this time, 1933 to be exact, that he became Friedrich von Hayek’s research assistant at the London School of Economics, where he focused on monetary theory. Like most of Hayek’s followers, Lachmann soon came under the influence of John Maynard Keynes, who in 1936 published The General Theory. Unlike many of Hayek’s other followers, Lachmann did not abandon Austrian capital theory; in fact, in 1956 he published Capital and Its Structure, a reformulation of what Hayek had written in his 1941 tome The Pure Theory of Capital. The fusion of Austrian subjectivism — the subjectivism of value, integrated with monetary theory — and Keynesian subjectivism — the subjectivism of expectations — became Lachmann’s principal contribution to economic science: radical subjectivism.

The Market as an Economic Process was written in the tradition of radical subjectivism. Published in 1986, the book came twelve years after the June 1974 South Royalton, Vermont, conference, which marked the beginnings of the ‘Austrian revival.’ At this conference, Lachmann posed a series of theoretical complications that form some of the central themes of his 1986 book. Is there a macroeconomic tendency towards equilibrium? If not, what processes do characterize the market? How ought we to go about studying the market and the processes which give form to it? The Market as an Economic Process is a re-visitation of these questions.

Lachmann’s book is a proposal. He provided future Austrian scholars a research program. His intention was to provide academics with a direction in which their research could go. This direction is towards greater subjectivism: a study of all the factors which influence and guide human action, the basic element of exchange. Lachmann’s proposed academic agenda is not an exclusive one. Indeed, Lachmann was to the Austrian School as John Hicks was to the Neoclassical — a great synthesizer of ideas. In providing the foundations for the great questions he poses, Lachmann does not revisit existing Austrian literature as he does post-Keynesian. He wanted to bring to the school’s attention that there exist ‘foreign’ traditions that have much to offer. It may even be the case that Lachmann hoped that his efforts would one day lead to some kind of reconciliation.
between the two schools: a fusion of the best of both.

The unifying motif constantly referred to throughout the book is an uncompromising rejection of the concept of market equilibrium. Lachmann accepts Hayek’s definition of equilibrium as a state of absolute consistency of plans. Knowing that actions are guided by plans, any changes in these implies disequilibrium. It follows that the market, as a process over time, cannot possibly attain a state of equilibrium, since this would imply a cessation of action. The concept of disequilibrated markets is not controversial, but the prevails the belief that there is at least a tendency towards equilibrium. That is, individuals change plans in order to coordinate with others, leading to a consistency between plans. Not so, argues Lachmann, since any attempt at coordination between individuals is necessarily both equilibrating and disequilibrating.

Imagine a hypothetical division of labor. Now suppose that an entrepreneur changes his plans as a means of garnering greater profit. This is partly an equilibrating force, since it is an attempt at coordinating the plans of the entrepreneur with the plans of the consumer. However, we also have to consider the effect the entrepreneur’s changes of plans will have on the plans of other entrepreneurs. What of those who had previously planned to coordinate with the entrepreneur before the latter’s alteration in direction? Alternatively, what of those who also had planned to coordinate in the same fashion as our entrepreneur, in such a way that it implies that now there are multiple individuals competing to coordinate with the same people? In a world of disequilibrium, where there is an extensive inconsistency in plans — not in a teleological sense, but relative to each other —, attempts to coordinate will lead to discoordination. It is the nature of the decentralized market where there coexists a large number of autonomous ‘agents.’

A world of disequilibrium, characterized by parallel forces of coordination and discoordination, is not a world in inimitable chaos. When suggesting that there is no overarching, unconquerable tendency towards equilibrium, Lachmann did not mean to imply that the real world is uncoordinated. The real world is one in which individuals attempt to coordinate with each other through the use of knowledge that can be attained through the market, but as a result disrupt each other’s incongruent plans. In other words, there still exists this impetus for coordination. The nervous system of the market, although Lachmann does not explicitly mention it — for reasons that will be mentioned below —, is the pricing process. His only argument is that the conception of the market process as one advancing towards some kind of equilibrium hides the very features which make the market dynamic. He is ridding economic science, once and for all, of any notion that may imply some level of determinateness.

The version of the market process Lachmann presents in The Market as an Economic Process is an ideal type — exactly the kind of device he contends ought to be the main tools used by economists to study economics. Ideal types necessarily abstract from certain features and exaggerate others. What Lachmann intends to exaggerate are the market forces which he so often references: those of coordination and discoordination. This hyperbole, of sorts, is interpreted to imply chaos, but, as aforementioned, it is actually just a means of underscoring the nature of the market. The book presents a model of a market heading in an unknown direction, regulated by endogenous and

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exogenous forces which are seemingly both inclusive and exclusive to each other.

Given that the future is unknowable, if only because human action is unpredictable, how then does one study the market process? Lachmann, influenced by Hicks, maintains that economic science is a borderline historical endeavor. Economics is a theoretical means of explaining relevant past events. Further, explanations for past events are not immutable laws which apply to all future events. The market process is a historical and progressive one, and as the market evolves and becomes more complex its nature will change along with it. As an example of changing relationships over time Lachmann points to money: “[a] timeless theory of money is hardly feasible.” This flies in the face of efforts by prior Austrians, namely Carl Menger and Ludwig von Mises, to establish economics as a science capable of pinning objective laws of human action.

Lachmann’s views can be tentatively reconciled with those of his Austrian predecessors, even if Lachmann himself would reject such efforts, if we assume him to have made a mistake. The mistake is the supposition that increases in complexity necessarily changes the nature of the system as a whole. Returning to money, we can track the growing complexity of money by looking at its evolution from a commonly traded commodity transformed into a medium of exchange to a broad category of claims, made up of an extensive palette of money substitutes. To make matters more difficult, it just happens to be that in a modern monetary economy some of these substitutes are money one day and not the next. Does this imply that none of the old monetary laws apply to the modern system, and that none of the modern monetary laws will apply to the system of tomorrow? The answer is no; the only thing Lachmann’s observation implies is that as the market becomes more complex, economic theory will have to match its complexity by explaining the causality between previously unconsidered variables.

Interpreted in this way, we see that Lachmann makes a very important point. Knowing that the market is an unpredictable process shaped by the intentions of man, and that it will grow in intricacy as man adds institutions that better serve his ends, we further know that whatever tools we use to explore the causal relationships that govern the market process as it presently exists must be added onto over time. In other words, any ideal type we construct is necessarily a work in progress, as what it is attempting to model is also a work in progress. We see now that Lachmann’s methodological argument is only an application of his principal thesis.

To be sure, the reader will find much to disagree with in *The Market as an Economic Process*. The book is not a regurgitation of previously established Austrian insights; as aforementioned, Lachmann is keen to introduce the views of economists of other schools as often as he can justify them. He heavily draws from post-Keynesian sources, including George L.S. Shackle and Victoria Chick, as well as John Hicks. Looking to synthesize good ideas, sometimes Lachmann erred in judgment.

For instance, Lachmann urged us to openly approach the post-Keynesian concept of the “fixprice” system. The fixprice pricing

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process is contrasted to the flexprice system, where the latter is characterized by the availability of the option to bargain or haggle over prices. This gives the buyer some degree of influence on the eventual price of the product. In modern industrial societies, however, prices are largely givens. The buyer must accept the price on the shelf—in many modern markets, buyers cannot influence prices and they become price takers. This is a clear rejection of the idea that it is marginal utility which decides prices. It fails to consider the constraints placed upon industry in deciding prices by the actions of their buyers. Lachmann seems to miss what it really means for a market to be one of price-takers. The term is not meant to imply that nobody literally sets prices, but only that prices cannot be decided on the whim of only one person’s marginal utility. The relationship of prices and marginal utility was best explained by Eugene von Böhm-Bawerk and Ludwig von Mises, yet their contributions are mysteriously missing when Lachmann judged the post-Keynesian concept of a fixprice economy.

Equally as perplexing is Lachmann’s reference to Mises’ 1913 book, The Theory of Money and Credit. In his discussion on the history of subjectivism in monetary theory, Lachmann considered Mises’ contribution to state “the main tenets of this [cash-balance approach], and hence of monetary subjectivism, with admirable precision and elegance.” Yet, Mises is never again mentioned while Lachmann analyzes the contributions of Irving Fisher, Arthur Pigou, Keynes, and Milton Friedman. To be sure, the book’s examination of these contributions is extremely critical, but Lachmann makes it seem as if the Austrians have not contributed at all. Returning to prices, he claims that the Austrians have not made good on their claim to provide a causal-genetic explanation of price formation—yet, this is perhaps the greatest contribution of the Austrian School to monetary theory.

Despite the specific shortcomings of Lachmann’s book, we must accept it for what it offers. He left it to the newer generation of Austrians to fill the holes he so ably unveils. Maybe his references to post-Keynesian ideas were meant as an incentive to better compare the contributions of different schools of thought. The Market as an Economic Process is most definitely a portal to ideas that most Austrians never make mention to. Moreover, Lachmann challenged us to rethink how we envision the market process to be. For the most part, his contribution is a positive one that Austrians ought to seriously consider. Given the state of progress in Austrian economics between 1986 and the present day, it is still conceivable that present and future scholars can fulfill Lachmann’s program of completing the subjectivist revolution in economics. Maybe his proposition that we can learn from others, including post-Keynesians, will be taken more seriously. Most important of all, we must accept the undeniable fact that economic science is an evolving body of knowledge, because it sets out to explain a perpetually evolving phenomenon.

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